No. 16004

In the United States Court of Appeals For the Ninth Circuit

THE IDAHO FIRST NATIONAL BANK, Appellant

v.

UNITED STATES OF AMERICA, Appellee

ON APPEAL FROM THE JUDGMENT
OF THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO,
SOUTHERN DIVISION

BRIEF FOR THE APPELLEE

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OPINION BELOW

The memorandum of decision,[1] findings of fact and conclusions of law of the District Court (R. 24-31) are not officially reported.

JURISDICTION

This appeal involves income taxes for the period from January 1, 1952, to May 10, 1952, in the sum of $3,957.36 allegedly overpaid by the taxpayer as transferee of the assets of the Wendell National Bank, together with interest as provided by law. (R. 3-11.) On May 29, 1956, taxpayer paid the transferee assessment of $3,957.36, plus interest of $896.22, or a total of $4,853.58; and on the same day, taxpayer filed a claim for refund. (R. 22, 29.) The Commissioner of Internal Revenue rejected the claim for refund on July 5, 1956. (R. 23, 30.) On July 24, 1956, and within the time prescribed by Section 3772 of the Internal Revenue Code of 1939, this suit was instituted in the District Court. Jurisdiction was conferred on the District Court by 28 U.S.C., Sections 1340 and 1346. Judgment was entered against the taxpayer on January 27, 1958. (R. 31-32.) Within sixty days thereafter, and on March 19, 1958, a notice of appeal to this Court was filed by taxpayer. (R. 32-33.) Jurisdiction is conferred upon this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether the District Court correctly upheld the determination of the Commissioner of Internal Revenue that accrued interest on notes receivable was

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1/ The memorandum of decision is not included in the printed record, and a copy is attached as Appendix B, infra.

reportable as income by a cash basis bank for the taxable period ending with its liquidation.

STATUTE AND REGULATIONS INVOLVED

These are set out in Appendix A, *infra*

STATEMENT

The facts as stipulated (R. 16-23) and found by the District Court (R. 24-30) may be summarized as follows:

Prior to May 10, 1952, the Wendell National Bank (Sometimes referred to as "Wendell" herein) was a corporation organized and existing under the National Bank Act, with its principal place of business at Wendell, Idaho. (R. 17, 24.)

On May 10, 1952, the taxpayer[2] (plaintiff-appellant herein) purchased the entire capital stock of the Wendell National Bank for the sole purpose of acquiring its assets. On the same day, and immediately after the purchase, a special meeting of stockholders was held and a resolution was passed authorizing dissolution of Wendell and distribution of all its assets to taxpayer. On the same day (May 10, 1952), and in accordance with this resolution, all the assets of Wendell were distributed to taxpayer and all liabilities of Wendell were assumed by the taxpayer. Thereafter, Wendell was fully liquidated for all intents and purposes. (R. 17-18, 24-25.)

2/ The term "taxpayer" is used herein for convenience in referring to the transferee, The Idaho First National Bank, although the transferor, Wendell National Bank, is the original taxpayer whose taxes are involved. No question as to transferee liability is presented and it is stipulated and found (R. 22, 29) that plaintiff in paying the transferee assessment has the right to contest the tax issue of the transferor and is liable as transferee for any additional tax owed by the transferor. See Section 311 of the Internal Revenue Code of 1939.

Wendell National Bank was in the general banking business and consistently reported its income on the cash basis method of accounting. On June 20, 1952, a corporation income tax return for the period January 1, 1952, through May 10, 1952, was filed in behalf of Wendell, and the tax shown to be due on the return was paid by the taxpayer. In that return there was included as taxable income the accrued interest on notes receivable in the amount of $10,843.55. This accrued interest on notes receivable was calculated at the time of Wendell's liquidation in order to determine the value of its assets for liquidation purposes, and it was calculated by computing the interest earned but not then payable on each note to the date of liquidation. Expenses attributable to this accrued interest on notes receivable had been deducted for income tax purposes when paid by Wendell prior to its liquidation. Unpaid accrued expenses of Wendell had not been deducted for income tax purposes at the date of liquidation. (R. 18-19, 25-26.)

The accrued interest was collected by taxpayer subsequent to the liquidation of Wendell, and when so collected was reported by taxpayer as income for tax purposes. However, taxpayer offset the collections against the allocated cost of the accrued interest on notes receivable, so that all of the amount collected was treated as recovery of cost and therefore not subject to income tax. (R. 23, 29-30.)

The individual stockholders of Wendell who sold their stock to taxpayer paid a capital gains tax on the excess of the selling price over the cost or other basis of their stock. (R. 23, 30.)

The Internal Revenue Service at first concluded

that the accrued interest was not taxable to Wendell since it was on the cash basis; and a refund was made to taxpayer accordingly. However, the matter was subsequently reconsidered, and after such reconsideration, the Commissioner of Internal Revenue changed his views and determined that the accrued interest was taxable to Wendell and that it should be included in the final return of Wendell for the short period (January 1, 1952, to May 10, 1952) ending with its liquidation. The Commissioner also determined that the amount of such accrued interest was $13,191.19 instead of $10,843.55. Accordingly, a deficiency notice was issued to taxpayer as transferee of Wendell's assets, and on May 29, 1956, taxpayer paid the transferee assessment of $3,957.36, plus interest of $896.22, or a total of $4,853.58. Taxpayer then filed a timely claim for refund, and after rejection of such claim taxpayer instituted this suit in the District Court. (R. 19-23, 26-30.)

The District Court upheld the Commissioner's determination and directed dismissal of taxpayer's complaint. (R. 30.) Judgment was entered in favor of the United States accordingly (R. 31-32), and taxpayer has appealed to this Court (R. 32-33).

SUMMARY OF ARGUMENT

The District Court correctly upheld the determination of the Commissioner of Internal Revenue that interest earned on notes receivable should be accrued to the date of liquidation of the Wendal National Bank and included in its final income tax return for the short period ending with its liquidation, notwithstanding the fact that it reported its income on the cash basis. That is so because Wendell's earnings

belonged to it and liability to tax thereon could not be discharged by the simple expedient of liquidation and distribution of the right to such income. This income was in fact realized by the transferor (Wendell) and should therefore be attributed to it without any special inquiry as to whether it was on the cash or accrual basis. And in the circumstances the Commissioner had the power and duty under Sections 22(a), 41 and 45 of the 1939 Code to tax this income to Wendell without regard to whether it was on the cash or accrual basis of accounting. Although the cash basis may have sufficed to clearly reflect Wendell's income during prior years, the situation was changed on account of its liquidation. This change prevented Wendell's accounting technique from clearly reflecting its income for the short period ending with its liquidation and justified the Commissioner in exercising his discretionary powers to protect the revenue. The decision of the District Court to that effect is in accord with the law, the Regulations and the court decisions, and it should accordingly be upheld by this Court.

ARGUMENT

THE DISTRICT COURT CORRECTLY UPHELD THE COMMISSIONER'S DETERMINATION THAT THE ACCRUED INTEREST IS TAXABLE TO WENDELL

We submit that this case was correctly decided by the District Court and its decision is supported by *United States* v. *Lynch*, 192 F. 2d 718 (C. A. 9th), certiorari denied, 343 U.S. 934. In that case it appeared that the corporation whose taxes were involved had followed the custom of reporting, for in-

come tax purposes, the expenses of warehousing activities on the accrual basis. However, storage income was not reported until the goods were withdrawn from storage and bills had been rendered and paid. Such a system had resulted in approximate matching of corporate expenses and revenues for the reason that in the ordinary course of business goods were stored for short terms and usually removed by June 30, the end of the corporation's taxable year. The last corporate tax return for the period ending with the liquidation of the corporation reported no storage income for goods which had not then been removed. The Commissioner held that in order to clearly reflect the taxpayer's income for its final tax period, the storage charges should be accrued to the date of liquidation and reported as income although this represented a departure from the method that the corporation had consistently used in the past. This Court held that the Commissioner acted within the limits of the discretion conferred upon him by Section 41 of the Internal Revenue Code of 1939 (Appendix A, *infra*) and that acceptance of the corporation's accounting method in prior years did not prevent the Commissioner from later exercising his statutory power within those limits. And in so holding, this Court said (192 F. 2d at p. 721):

> We think the Commissioner acted within the limits of the discretion conferred upon him by 26 U.S.C.A. §41, "* * * if the [taxpayer's accounting] method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income." Acceptance of the corporation's account-

ing method in prior years did not prevent the Commissioner from later exercising his statutory power within proper limits. The fundamental change in the corporation's circumstances, that is, its liquidation and consequent non-existence, prevented its accounting technique from achieving the rough matching of expenses and income previously attained.

We understand appellant to contend that the income in question is not that of the corporation. The answer is, that the corporation has performed the services which create the right to the income which brings into play the basic rule that income shall be taxed to him who earns it. *Helvering* v. *Eubank*, 1940, 311 U.S. 122, 61 S.Ct. 149, 85 L.Ed. 81. A corporate liquidation and transfer of assets cannot divert taxability of income already earned any more than does an assignment of such income. Cf. *Helvering* v. *Horst*, 1940, 311 U.S. 112, 61 S.Ct. 144, 85 L.Ed. 75; *Helvering* v. *Eubank*, *supra*. Appellant further argues that granting there was corporate income it should not be taxed to the corporation because of the peculiar circumstances of this case. However, "a taxpayer * * * canot avoid taxes by the simple expedient of not completing its contracts; and where a corporation puts itself in such a position that it could never complete its contracts, it is in no position to insist that even if it had income it has no tax liability". Cf. *Jud Plumbing & Heating Inc.* v. *C. I. R.*, 5 Cir., 1946, 153 F. 2d 681, 685. In the cited case a corporation, reporting on the completed contract method, was in effect placed on the accru-

al method for the tax period terminating with the corporate liquidation in order to more clearly reflect its income for the final period of its existence. Similarly, a corporate taxpayer on the cash method has been required to accrue certain income items in it final return in order to properly reflect income. *Carter* v. *C. I. R.*, 9 T. C. 364, 1947. Here, the Commissioner seeks to impose no such drastic revision of accounting method on the corporation for, as has been noted, the corporation accrued expense items incident to the operation of its business. Consistency in the reporting of all items of income and expense is all that is asked of the taxpayer in this case.

In the instant case, the situation is not materially different from the one in the *Lynch* case, for here as there the liquidation and consequent non-existence of the corporation prevented its accounting technique from clearly reflecting its income for the short period ending with its liquidation; and here as there the Commissioner was justified in exercising the supervisory power conferred upon him by Section 41 of the 1939 Code (Appendix A, *infra*).

The decision of the District Court in the instant case is not only in line with *Lynch* but with other authorities as well, some of them being as follows: *Jud Plumbing & Heating* v. *Commissioner*, 153 F. 2d 681 (C. A. 5th); *Dillard-Waltermire* v. *Campbell*, 255 F. 2d 433 (C. A. 5th); *Standard Paving Co.* v. *Commissioner*, 190 F. 2d 330 (C. A. 10th), certiorari denied, 342 U.S. 860; *Carter* v. *Commissioner*, 9 T. C. 364, affirmed on another issue, 170 F. 2d 911 (C. A. 2d); *Floyd* v. *Scofield*, 193 F. 2d 594 (C. A. 5th); Rev. Rul. 255, 1953-2 Cum. Bull. 10.

The fundamental principle underlying all of these authorities is that the corporation's earnings belong to it and liability to tax thereon cannot be discharged by the simple expedient of liquidation and distribution of the right to such income. See *United States* v. *Lynch, supra,* 192 F. 2d at p. 721; *Carter v. Commissioner, supra,* 9 T. C. at pp. 373-374. Cf. *Lucas* v. *Earl,* 281 U.S. 111; *Helvering v. Horst,* 311 U.S. 112; *Helvering* v. *Eubank,* 311 U.S. 122; *Commissioner* v. *Lake,* 356 U.S. 260.

It is elementary that in enacting the gross income statute (Section 22 (a) of the Internal Revenue Code of 1939, *Appendix A. infra*), Congress undertook to exert the full measure of its taxing power (*Commissioner* v. *Glenshaw Glass Co.,* 348 U.S. 426, 429); and in order to assist the Commissioner in carrying out the Congressional intent he was given broad discretionary powers with respect to the use of accounting methods and systems so as to clearly reflect the taxable income and thereby protect the revenue. Sections 41, 42 and 45 of the Internal Revenue Code of 1939 (Appendix A, *infra*); cf. *Lucas* v. *American Code Co.,* 280 U.S. 445, 449; *Brown* v. *Helvering,* 291 U.S. 193, 204-205; *Automobile Club* v. *Commissioner,* 353 U.S. 180, 189. It should also be noted that income may be realized in a variety of ways, other than by direct payment to the taxpayer, and, in such situations, the income may be attributed to him when it is in fact realized, without any special inquiry as to whether he is on the cash or accrual basis. *Brown* v. *Commissioner,* 22 T. C. 147, 151, affirmed, 220 F. 2d 12 (C. A. 7th).

It is true that Section 39.22(a)-20 of Treasury Regulations 118 (Appendix A, *infra*) does provide

that no gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation; but while that provision operates to preclude taxing a corporation on capital gains resulting from sale of the distributed assets by the shareholders (*United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451), still, it does not apply in respect to income earned by the corporation up to the time of liquidation even though such income has not been received by the corporation. See Rev. Rul. 255, *supra*.

Moreover, the instant transaction amounted in essence to a purchase by taxpayer of Wendell's assets for their fair value and we do not understand this to be disputed. Here taxpayer purchased the entire capital stock of Wendell for the sole purpose of acquiring Wendell's assets; the amount paid for the stock was determined by the value of such assets; and the liquidation and transfer of the assets to taxpayer was consumated on the same day the stock was purchased. (R. 17-18, 24-25.) In the circumstances, the entire transaction, considered as a whole as of course it should be, amounted in substance to a purchase of property with the cost of the stock allocable to the property. *Kimbell-Diamond Milling Co.* v. *Commissioner*, 14 T. C. 74, affirmed, 187 F. 2d 718 (C. A. 5th); *Commissioner* v. *Ashland Oil & R. Co.*, 99 F. 2d 588 (C. A. 6th), certiorari denied, 306 U.S. 661; *Estate of Suter* v. *Commissioner*, 29 T. C. 244, 258-259.

And if we look at the instant situation as a purchase of property including accrued interest on notes receivable then it seems clear that Wendell realized income in the amount of the interest accrued to the

date of liquidation (*Fisher* v. *Commissioner*, 209 F. 2d 513 (C. A. 6th), certiorari denied, 347 U.S. 1014; *United States* v. *Snow*, 223 F. 2d 103 (C. A. 9th), certiorari denied, 350 U.S. 831; *Hort* v. *Commissioner*, 313 U.S. 28; *Commissioner* v. *Lake*, *supra*) since it was in effect collected as part of the purchase price. As the Court said in *Minnesota Tea Co.* v. *Helvering*, 302 U.S. 609, 313: "A given result at the end of a straight path is not made a different result because reached by following a devious path."

In the circumstances, we submit that the District Court in the instant case rightly concluded that the accrued interest in controversy is taxable to Wendell as determined by the Commissioner.

The taxpayer says (Br. 9-11) that the Wendell bank had for many years consistently used the cash basis of accounting and that a taxpayer reporting on a cash basis must be consistent and cannot accrue either receipts or disbursements. We do not dispute this as a general proposition nor do we have any quarrel with cases as *Osterloh* v. *Lucas*, 37 F. 2d 277 (C. A. 9th) and *Martinus & Sons* v. *Commissioner*, 116 F. 2d 732 (C. A. 9th), cited by taxpayer. Indeed, we note that Judge Healy of this Court, who acted as a District Judge in the instant case, wrote the opinion of the Court in the *Martinus* case.

The taxpayer says (Br. 11) that the instant notes had not matured, and the interest on them was not due nor payable at the time of the liquidation. That may be so, but it makes no difference here and it does not show that the interest had not accrued in the accounting sense and for tax purposes as well, since interest, like rent, can be said to accrue from day to day, or ratably over an elapsed period of time. 2 Mer-

tens, Law of Federal Income Taxation (1955 ed.), Section 12.95; *Miller & Vidor Lumber Co.* v. *Commissioner*, 39 F. 2d 890 (C. A. 5th), certiorari denied, 282 U.S. 864. It is the right to receive which is important to determine accruals and when the right to receive an amount becomes fixed, the right accrues even though the amount has not yet become due or payable. *Spring City Co.* v. *Commissioner*, 292 U.S. 182; *United States* v. *Anderson*, 269 U.S. 422; *Daley* v. *United States*, 243 F. 2d 466 (C. A. 9th), certiorari denied, 355 U.S. 832. Indeed we do not understand that there is any dispute as to these principles in the instant case, and it was stipulated and found (R. 23, 29) that the interest in question had accrued at the time of the liquidation. The only question here presented is whether the Commissioner had authority to add this accrued interest to Wendell's income for the short period ending with its liquidation, and we submit that he did for the reasons given in this brief.

The taxpayer says (Br. 12) that Wendell had expenses attributable to this accrued interest, and such expenses were not accrued by the Commissioner to the time of liquidation. However, the stipulation and finding show (R. 19, 26) that expenses attributable to this accrued interest had been deducted for income tax purposes when paid by Wendell prior to its liquidation; also that unpaid accrued expenses of Wendell had not been deducted for income tax purposes at the date of liquidation. We may conclude from this that expenses attributable to the accrued interest had been deducted currently prior to the liquidation. But if any of these expenses had not been so deducted, then taxpayer, which had the burden of

proof (*Helvering* v. *Taylor*, 293 U.S. 507, 514), should have established their nature and amount in the District Court so they could be given consideration. Apparently, taxpayer did not undertake to do this, and in the circumstances, we submit that there is no adequate basis for taxpayer's contention here.

Taxpayer cites (Br. 13) *United States* v. *Horschel*, 205 F. 2d 646 (C. A. 9th); *Commissioner* v. *Henry Hess Co.*, 210 F. 2d 553 (C. A. 9th); *Herbert* v. *Riddell*, 103 F. Supp. 369 (S.D. Cal.); and *Telephone Directory Advertising Co.* v. *United States*, 142 F. Supp. 884 (C. Cls.). But all of those cases are distinguishable from the instant one on the facts, and none of them sustains the contention of the taxpayer here. Here we have a situation closely resembling the ones in cases such as *Lynch* and *Jud Plumbing* which we submit were correctly decided and should be followed here. In this connection it will be noted that in the *Telephone Directory* case, *supra*, the Court of Claims referred to and cited with approval not only the decisions of this Court in the *Horschel* and *Hess* cases (see 142 F. Supp. at p. 889), but also the decision of the Fifth Circuit in the *Jud Plumbing* case, saying with regard to the latter (142 F. Supp. at pp. 889-890):

> The defendant's reliance on the completed contract cases, represented by *Jud Plumbing & Heating, Inc.*, v. *Commissioner*, 5 Cir., 153 F. 2d 681, and *Standard Paving Co.* v. *Commissioner*, 10 Cir., 190 F. 2d 330, certiorari denied, 342 U.S. 860, 72 S.Ct. 87, 96 L.Ed. 647, is misplaced. In those cases the Commissioner properly accrued the income to the corporations that were using the completed contract method, which al-

> lows the postponement of accrued income, because it more accurately reflected income. In those cases the accrual was made only to the date of liquidation. In all those cases the right to receive the income was fixed and definite and in some instances the income had already been received.

In the instant case, the accrual was made only to the date of liquidation and the right to receive the income was fixed and definite. In the circumstances, the action taken by the Commissioner was well within the bounds of his statutory authority to require computations which clearly reflect income; and as we have pointed out above, the decision of the District Court to that effect is amply supported by authorities such as the *Lynch* decision of this Court and the *Jud Plumbing* case in the Fifth Circuit. [3] The taxpayer's objections and criticisms are without merit, and they should be rejected here as they were by Judge Healy in the District Court.

It remains to add a few words as to the brief of the *amici curiae* who have joined the appellant in urging this Court to reverse the decision of the lower court herein. The *amici curiae* state (Br. 3) that the final income tax return of the Wendell Bank, for the period ending May 10, 1952, was filed on the accrual basis. We do not understand that to be so, and we would point to the return itself (Stip. Ex. C)

3/ Cases such as PATCHEN v. COMMISSIONER, decided July 23, 1958 (C. A. 5th); and GOODRICH v. COMMISSIONER, 243 F. 2d 686 (C. A. 8th) are not in point and do not aid the instant taxpayer irrespective of whether they may be considered correct. Those cases deal with changes in accounting methods of going concerns, while here we are concerned with a liquidated corporation which by its act of liquidating and going out of existence prevented its accounting technique from clearly reflecting its income for the short period ending with its liquidation. See UNITED STATES v. LYNCH, SUPRA.

which on page 3 gives as an answer to question 9 that the return was prepared on the cash basis. In fact, nobody has contended otherwise, so far as we know, and the fundamental question here presented is whether in the circumstances the Commissioner had authority to require inclusion of accrued interest on notes receivable to the date of Wendell's liquidation even though generally speaking the return was made on the cash basis.

The *amici curiae* contend (Br. 4-7) that the Commissioner can not do this even if necessary to clearly reflect income, and that if the Commissioner wants to make a change he must put Wendell's income and deductions upon an accrual basis for the entire period and not merely add the accrued interest to an otherwise cash basis return as that would result in a hybrid method which is not countenanced by the law.

It may be that hybrid methods are not generally favored, and the general rule is against accounting for and reporting income partly on the cash and partly on the accrual basis. *Mass. Mutual Life Ins. Co.* v. *United States*, 288 U.S. 269; *Security Mills Co.* v. *Commissioner*, 321 U.S. 281. However, it is equally clear that hybrid methods are both acceptable and necessary in some instances where they clearly reflect income (*Schram* v. *United States*, 118 F. 2d 541 (C. A. 6th); *SoRelle* v. *Commissioner*, 22 T. C. 459, 468-469; 2 Mertens, Law of Federal Income Taxation (1955 ed.), Section 12.05a; cf. *Kahuku Plantation Co.* v. *Commissioner*, 132 F. 2d 671 (C. A. 9th); and, indeed, such methods are explicitly recognized to some extent under Section 446(c) of the the 1954 Code do not represent any radical change

here, because here we are dealing with the taxable period ending May 10, 1952, which is governed by the 1939 Code as stated above. However, it would seem appropriate to add that the new provisions of the 1954 Code do not represent any radical change in the law since hybrid methods of accounting although not generally appropriate have long been sanctioned under the 1939 Code and prior law where necessary to clearly reflect income, as we have indicated above.

Moreover, the cases upon which we chiefly rely, such as *United States* v. *Lynch*, *supra*, and *Jud Plumbing & Heating* v. *Commissioner*, *supra*, strongly support the view that hybrid methods may be resorted to where necessary to clearly reflect income and protect the revenue in situations like the one at bar.

Waldheim Realty & Inv. Co. v. *Commissioner*, 245 F. 2d 823 (C. A. 8th), cited in the *amici* brief (Br. 5), is distinguishable on the facts and represents quite a different taxable situation, irrespective of whether it may be considered as correctly decided.

The *amici curiae* reiterate their contention (Br. 7-8) that it is beyond the power of the Commissioner to require Wendell to include the accrued interest in its final return; and they argue that such inclusion produces a distortion of income, apparently basing their argument mainly upon the untenable proposition that no deviation can ever be made from a strict cash or a strict accrual method (whichever is applicable) and that if there be any such deviation, however slight, then *a fortiori* there must be an ensuing distortion of income to that extent.

This argument of the *amici curiae* is not only at

variance with the established law and practice, but it really assumes the question and does not meet the basic issue as to whether the Commissioner can require a cash basis taxpayer to report accrued income in its final return where such income was earned by it prior to its liquidation and dissolution. Moreover, if not so taxed in the instant case, the income might escape taxation altogether since the distributee in liquidation (taxpayer herein) concededly offset its costs against the amount of interest that it eventually received. (R. 23, 29-30.)

In the circumstances of this case, the accrued income was actually realized by Wendell prior to liquidation, as we have pointed out above, and in such circumstances it make no difference whether Wendell was on the cash or accrual method of accounting. Cf. *Brown* v. *Commissioner, supra.* In either case, Wendell constructively received the amount of this accrued interest as a part of the purchase price for the transferred assets. *Kimbell-Diamond Milling Co.* v. *Commissioner, supra; Commissioner* v. *Ashland Oil & R. Co., supra; Estate of Suter* v. *Commissioner, supra.*

And even if there had been no purchase of stock with intention to liquidate and immediately acquire the assets, still, the result would be the same for as pointed out by this Court in the *Lynch* case, *supra*, the fundamental change in the corporation's circumstances, that is, its liquidation and consequent nonexistence, prevented its accounting technique from clearly reflecting its income for the short period ending with its liquidation; and a corporate liquidation and transfer of assets cannot divert taxability of income already earned any more than does an assign-

ment of such income.

The *amici curiae* refer (Br. 8-9) to Treasury Regulations 111, Section 29.52-1 (which is substantially the same as Treasury Regulations 118, Section 39.52-1, Appendix A, *infra*, here applicable). This regulation provides that a corporation is not in existence after it ceases business and dissolves, retaining no assets. See *United States* v. *Loo*, 248 F. 2d 765 (C. A. 9th), certiorari denied, 356 U.S. 928. However, that provision is clearly not at variance with our views and it does not support the extreme contentions of the taxpayer here. It is true that in the *Hess* case, *supra*, this Court reaffirmed its earlier decision in the *Horschel* case, *supra*, and said (210 F. 2d at p. 558) that where shareholders of a fully dissolved corporation receive money or other property which would have been taxable income to the corporation at that time, if the corporation were still in existence, the corporation is not taxable thereon. But in that connection, this Court did not hold nor purport to hold that the Commissioner could not make an allocation of income in a situation like the one at bar so that the amount accrued to date of liquidation will be taxed to the liquidating corporation in its final return regardless of whether it happens to be on the cash or accrual basis. Such an allocation and treatment of interest is supported by and consistent with decisions such as *United States* v. *Lynch, supra; Jud Plumbing & Heating* v. *Commissioner, supra; United States* v. *Horschel, supra; Commissioner* v. *Henry Hess Co., supra,* none of which is discussed or even cited in the brief of the *amici curiae*. And see 2 Mertens, Law of Federal Income Taxation (1955 ed.) Section 17.17.

The *amici curiae* say (Br. 11) that it is apparent that under any handling of the situation, the entire amount of interest will be reported as a part of the gross income of some taxpayer. But the *amici curiae* do not mention nor discuss the stipulated fact (R. 23, 29-30) that the transferee in the instant case (Idaho First National Bank), although reporting as income the interest when collected, nevertheless offset the collections against the allocated cost, so that all of the amount collected was recovery of cost and not subject to income tax. The method prescribed by the Commissioner would prevent an incongruous result and would achieve the desirable result of taxing the accrued interest to the one (Wendell) who earned it.

As we have indicated above, the *amici curiae* brief makes no effort to reconcile or explain the cases such as *Lynch* and *Jud Plumbing* which are most analogous to the situation at bar, but rather chooses to ignore them. And in the circumstances we can only conclude that the *amici curiae* are asking this Court to depart from the principles for which such cases stand. We submit that there is no adequate basis in the law, the Regulations or the applicable court decisions for any such deviation, and therefore the determination of the District Court herein should be upheld by this Court.

CONCLUSION

The jugment of the court below should be affirmed.

Respectfully submitted,

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October, 1958

APPENDIX A

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.* — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal servise, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * * *

(26 U.S.C. 1952 ed., Sec. 22)

SEC 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SECTION 42. (As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687) PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a difference period. * * *

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(26 U.S.C. 1952 ed., Sec. 42.)

SEC. 45. (As amended by Sec. 128 (b) of the Revenue Act of 1943, c. 63, 58 Stat. 21) ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

(26 U.S.C. 1952 ed., Sec. 45.)

SEC. 47. RETURNS FOR A PERIOD OF LESS

THAN TWELVE MONTHS.

* * * * * * *

(g) [As added by Sec. 135 (c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Returns Where Taxpayer Not In Existence For Twelve Months.*— In the case of a taxpayer not in existence during the whole of an annual accounting period ending on the last day of a month, or, if the taxpayer has no such annual accounting period or does not keep books, during the whole of a calendar year, the return shall be made for the fractional part of the year during which the taxpayer was in existence.

(26 U.S.C. 1952 ed., Sec. 47.)

SEC. 48. DEFINITIONS.

When used in this chapter—

(a) [As amended by Sec. 135 (d) of the Revenue Act of 1942, *supra*] *Taxable Year.*—"Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. "Taxable year" means, in the case of a return made for a fractional part of a year under the provisions of this chapter or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made.

* * * * * * *

(c) *"Paid Or Incurred," "Paid Or Accrued."*— The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

(26 U.S.C. 1952. ed., Sec. 48.)

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation, subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. * * *
(26 U.S.C. 1952 ed., Sec. 52.)

* * * * * * *

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

Sec. 39.22 (a)-20. *Gross income of corporation in liquidation.* When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298). Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however, they may have appreciated or depreciated in value since their acquisition. * * *

Sec. 39.41-1. *Computation of net income.* Net

income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 39.42-1 to 39.42-3, inclusive). If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 39.41-2. *Bases of computation and changes in accounting methods.* (a) Approved standard method of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definition of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by

the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. But see sections 42 and 43. See also section 48. For instance, in any case in which it is necessary to use an inventory, no method of accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See sections 39.42.2 and 39.42-3.) On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. * * *

* * * * * * *

Sec. 39.41-3 *Methods of accounting.* It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. * * *

* * * * * * *

Sec. 39.52-1. *Corporation returns.* * * *

(b) A corporation having an existence during any portion of a taxable year is required to make a return. If a corporation was not in existence throughout an annual accounting period (either calendar year or fiscal year), the corporation is required to make a return for that fractional part

of a year during which it was in existence. A corporation is not in existence after is ceases business and dissolves, retaining no assets, whether or not under State law it may thereafter be treated as continuing as a corporation for certain limited purposes connected with winding up its affairs, such as for the purpose of suing and being sued. If the corporation has valuable claims for which it will bring suit during this period, it has retained assets, and it continues in existence. * * *

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APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO
SOUTHERN DIVISION

THE IDAHO FIRST NATIONAL BANK,
Plaintiff,
vs.
UNITED STATES OF AMERICA,
Defendant.

CIVIL NO. 3269

MEMORANDUM OF DECISION

The facts in this suit for refund are stipulated, so that the sole question for decision is one of law.

It is my opinion that the position taken by the Commissioner is warranted by statute and has ample support in the decisions.

Let judgment in favor of the United States be entered accordingly.

WILLIAM HEALY
Acting District Judge

Dated October 4, 1957.